

ALTERNATIVE FORECASTS

DRI has assigned a 60% probability of occurrence to its September 1999 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP grows 3.8% in 1999, 2.7% in 2000, 2.8% in 2001, 2.1% in 2002, and 2.5% in 2003;
- U.S. nonfarm employment advances 2.1% this year, 1.7% next year, 1.6% in 2001, then averages about 1.0% thereafter;
- the U.S. civilian unemployment rate remains at 4.2% over most of the forecast period, and rises to just above 4.5% in 2002 and 2003;
- consumer confidence peaks in 1999, then slowly tapers off over the forecast period;
- consumer inflation remains well below 3.0%;
- the federal budget surplus increases in each year of the forecast;
- and the U.S. merchandise trade deficit widens.

While the baseline scenario represents the most likely path for the national economy over the next few years, uncertainties surrounding several key variables mean other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their impacts on the Idaho economy, are discussed below.

While it is believed the economy will not suffer a recession over the forecast period, it should be noted that the risk of a recession is high. A review of the probabilities of occurrence for each forecast scenario shows this. The baseline does not include a recession and its probability of occurrence is 60%. However, both of the alternative scenarios do contain recessions and their combined probability of occurrence is 40%. This implies the chances of the economy not suffering a recession over the next few years are just better than even.

STOCK-MARKET-CORRECTION SCENARIO

The *Stock-Market-Correction Scenario* has been assigned a 10% probability of occurrence. The near-term risk to the U.S. forecast continues to be a major stock market correction. According to DRI's estimates, the stock market is overvalued by about a third. This scenario assumes the stock market corrects for this over valuation next year. Obviously, it is easier speculate what will cause the stock market drop than to predict its exact timing, although the latter would be more profitable. The U.S. stock market correction could be triggered by another crisis in Asia. The market survived the 1997 Asian financial crisis and the 1998 hedge fund collapse, but a third crisis may prove to be too much. Such a collapse destroys the recent buildup in wealth and results in a \$100-billion decline in consumer spending. This leads to a recession the same year.

This recession is expected to be relatively mild, with a 1.6% peak-to-trough decline in real GDP. This is because it is assumed the Federal Reserve will move quickly against any downturns. In 2000, it is expected that inflation will still be modest so the Federal Reserve will have more room to drop interest rates. Not surprisingly, the interest-rate-sensitive sectors of the economy recover the quickest.

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
OCTOBER 1999

	BASELINE				STOCK MARKET CORRECTION				LATE RECESSION			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
GDP (BILLIONS)												
Current \$	8,949	9,323	9,753	10,146	8,941	9,070	9,473	9,884	8,955	9,457	10,100	10,290
% Ch	5.1%	4.2%	4.6%	4.0%	5.1%	1.4%	4.4%	4.3%	5.2%	5.6%	6.8%	1.9%
1992 Chain-Weighted	7,841	8,050	8,274	8,448	7,835	7,850	8,106	8,341	7,847	8,141	8,443	8,333
% Ch	3.8%	2.7%	2.8%	2.1%	3.8%	0.2%	3.3%	2.9%	3.9%	3.7%	3.7%	-1.3%
PERSONAL INCOME - CURR \$												
Idaho (Millions)	27,480	28,967	30,490	32,033	27,473	28,610	29,948	31,386	27,484	29,166	31,211	32,841
% Ch	6.1%	5.4%	5.3%	5.1%	6.1%	4.1%	4.7%	4.8%	6.1%	6.1%	7.0%	5.2%
U.S. (Billions)	7,483	7,846	8,220	8,568	7,481	7,711	8,001	8,341	7,485	7,908	8,454	8,794
% Ch	5.0%	4.8%	4.8%	4.2%	5.0%	3.1%	3.8%	4.2%	5.0%	5.7%	6.9%	4.0%
PERSONAL INCOME - 1992 \$												
Idaho (Millions)	24,012	24,827	25,637	26,358	24,006	24,580	25,361	26,135	24,013	24,870	25,723	26,169
% Ch	4.5%	3.4%	3.3%	2.8%	4.5%	2.4%	3.2%	3.1%	4.5%	3.6%	3.4%	1.7%
U.S. (Billions)	6,539	6,727	6,913	7,052	6,537	6,628	6,777	6,947	6,540	6,747	6,969	7,009
% Ch	3.4%	2.9%	2.8%	2.0%	3.4%	1.4%	2.3%	2.5%	3.4%	3.2%	3.3%	0.6%
TOTAL NONFARM EMPLOYMENT												
Idaho (Thousands)	533.7	545.5	557.4	568.8	533.6	540.9	551.3	565.0	533.7	547.2	561.5	567.2
% Ch	2.3%	2.2%	2.2%	2.1%	2.3%	1.4%	1.9%	2.5%	2.3%	2.5%	2.6%	1.0%
U.S. (Millions)	128.5	130.7	132.9	134.1	128.5	128.9	130.2	132.3	128.5	131.4	134.7	133.6
% Ch	2.1%	1.7%	1.6%	0.9%	2.1%	0.3%	1.0%	1.6%	2.2%	2.2%	2.5%	-0.8%
GOODS PRODUCING SECTOR												
Idaho (Thousands)	111.2	112.2	115.3	117.7	111.2	109.3	112.9	116.7	111.3	113.6	118.5	116.8
% Ch	0.0%	0.9%	2.8%	2.1%	-0.1%	-1.7%	3.3%	3.3%	0.0%	2.1%	4.3%	-1.5%
U.S. (Millions)	25.2	24.8	24.7	24.5	25.2	24.2	23.8	24.0	25.2	25.1	25.4	24.5
% Ch	-0.6%	-1.4%	-0.7%	-0.9%	-0.6%	-3.8%	-1.7%	0.9%	-0.5%	-0.4%	1.1%	-3.5%
SERVICE PRODUCING SECTOR												
Idaho (Thousands)	422.4	433.3	442.1	451.2	422.4	431.6	438.4	448.3	422.4	433.6	443.0	450.4
% Ch	3.0%	2.6%	2.0%	2.1%	2.9%	2.2%	1.6%	2.3%	3.0%	2.6%	2.1%	1.5%
U.S. (Millions)	103.3	105.9	108.2	109.7	103.3	104.7	106.4	108.3	103.3	106.3	109.3	109.1
% Ch	2.8%	2.5%	2.2%	1.3%	2.8%	1.3%	1.7%	1.8%	2.9%	2.8%	2.8%	-0.1%
FINANCIAL MARKETS												
Federal Funds Rate	5.0%	5.5%	5.5%	5.5%	5.0%	4.6%	4.5%	4.5%	5.0%	5.3%	6.5%	6.7%
Bank Prime Rate	8.0%	8.5%	8.5%	8.5%	8.0%	7.6%	7.5%	7.5%	8.0%	8.3%	9.5%	9.7%
Mort Rate, New Homes	7.2%	7.8%	7.3%	7.1%	7.2%	7.6%	7.0%	6.8%	7.2%	7.6%	7.4%	8.0%
INFLATION												
GDP Price Deflator	1.3%	1.5%	1.8%	1.9%	1.3%	1.3%	1.1%	1.4%	1.3%	1.8%	3.0%	3.2%
Personal Cons Deflator	1.5%	2.0%	1.9%	2.2%	1.5%	1.7%	1.5%	1.7%	1.6%	2.5%	3.5%	3.4%
Consumer Price Index	2.2%	2.5%	2.3%	2.5%	2.2%	2.3%	1.8%	2.0%	2.2%	3.0%	3.9%	3.8%

Forecast Begins the SECOND Quarter of 1999

The bulk of the national slowing will be felt locally in 2000 and 2001. Idaho nonfarm employment grows by just 1.4% and 1.9% during these two years. In comparison, nonfarm employment advances 2.2% in both 2000 and 2001 in the baseline case. It does grow faster in 2002 than in the baseline, but not fast enough to make up lost ground. Idaho nonfarm employment is down about 4,000 from its baseline counterpart in 2002. Like employment, Idaho nominal personal income slows from its baseline pace in the next two years. Similarly, despite rising faster in 2002, it is still below the baseline personal income in 2002.

LATE-RECESSION SCENARIO

The *Late-Recession Scenario* has been assigned a 30% probability of occurrence. This is thrice the likelihood of the *Stock-Market-Correction Scenario* because the *Late-Recession Scenario* is a more typical end-of-expansion recession. In this scenario, the U.S. economy grows stronger in 1999-2000 than in the baseline. As a result, the unemployment rate stays low, which keeps consumer confidence elevated. In addition, it is assumed that a federal tax cut is enacted. The U.S. stock market keeps climbing. Consumer spending booms under these conditions. This boom is helped further by an accommodating Federal Reserve that keeps interest rates low. However, tighter labor markets eventually push inflation higher. Commodity prices also rebound as foreign economies recover and the U.S. economy surges. Inflation reaches 4.5% by the end of 2001.

As inflationary pressures bubble to the surface, the Federal Reserve finally takes action. It raises interest rates sharply beginning in late 2000. The federal funds rate moves to 7.5%. The bond market reacts even before the Federal Reserve, with yields climbing sharply in 2001 as inflationary pressures build. The yield curve inverts late in 2001, signaling the start of the recession. The Federal Reserve would like to end the recession quickly, but finds its options limited by high inflation. As a result, this recession is deeper and longer than the one depicted in the *Stock-Market-Correction Scenario*.

In this scenario, Idaho's economy grows faster in 2000 and 2001, before turning south in 2002. Idaho nonfarm employment rises 2.5% in 2000 and 2.6% in 2001, versus 2.2% in both years in the baseline. Idaho nominal personal income growth is 0.7 percentage points higher in 2000 and 1.7 percentage points higher in 2001. Both employment and personal income growth drop below their respective baseline paces, but momentum from previous years helps the actual levels of these measures remain above baseline levels.